

Message Text

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67

ACTION ARA-20

INFO OCT-01 ISO-00 CIAE-00 DODE-00 PM-07 H-03 INR-11 L-03

NSAE-00 NSC-07 PA-04 RSC-01 PRS-01 SP-03 SS-20

USIA-15 AID-20 EB-11 CIEP-03 TRSE-00 STR-08 OMB-01

CEA-02 COME-00 FRB-03 XMB-07 OPIC-12 LAB-06 SIL-01

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TO SECSTATE WASHDC 0393

INFO AMEMBASSY ASUNCION

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AMEMBASSY BUENOS AIRES

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TAGS: EGEN, CI, ECON, EINV, EAID

SUBJECT: CHILE'S ECONOMY ONE YEAR AFTER ALLENDE

1. SUMMARY: THE FIRST ANNIVERSARY OF THE NEW GOVERNMENT SEES MOST SECTORS OF THE ECONOMY EXPANDING AT A MODEST TO RAPID RATE, THE RESTORATION OF RELATIVELY FREE MARKETS FOR MOST GOODS AND SERVICES, A DECLINING THOUGH STILL EXTREMELY HIGH RATE OF INFLATION, A MUCH IMPROVED EXTERNAL FINANCIAL POSITION, AND THE IMPLEMENTATION OF ECONOMIC POLICIES INTENDED TO LAY THE BASE FOR FUTURE RAPID ECONOMIC GROWTH. PROSPECTS FOR THE SUCCESS OF THE GOC'S BOLD ECONOMIC REHABILITATION PROGRAM, HOWEVER, ARE CLOUDED

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BY THE BALANCE OF PAYMENTS PROBLEMS WHICH COULD ARISE

IF THE INTERNATIONAL COPPER PRICE REMAINS LOW AND TERMS OF TRADE CONTINUE TO MOVE AGAINST CHILE. END SUMMARY.

2. DURING THE PAST YEAR CHILE'S TEAM OF ECONOMIC TECHNICIANS HAS PUT INTO EFFECT A PACKAGE OF MEASURES AIMED AT RESTORING A VIABLE MARKET ECONOMY. POLICIES CONDUCIVE TO GROWTH OF OUTPUT AND TO THE ELIMINATION OF MANY OF THE DISTORTIONS WHICH HAVE LONG CHARACTERIZED THE CHILEAN ECONOMY HAVE BEEN IMPLEMENTED. THE BLACK MARKET IN GOODS HAS BEEN ELIMINATED; THE GOVERNMENT DEFICIT AS PERCENTAGE OF ITS TOTAL EXPENDITURES HAS BEEN REDUCED FROM 42 PERCENT IN 1973 TO 20-25 PERCENT IN 1974; MOST ENTERPRISES SEIZED BY THE ALLENDE GOVERNMENT HAVE BEEN RETURNED TO THEIR FORMER OWNERS AND THE DEFICITS OF ENTERPRISES REDUCED; RESTRAINTS ON CREDIT, PARTICULARLY TO THE GOVERNMENT SECTOR, HAVE REDUCED THE RATE OF INFLATION; FOLLOWING DECLINES IN 1972 AND 1973, AGGREGATE OUTPUT SHOULD REGISTER A RISE OF ABOUT 5 PERCENT IN 1974, WITH AGRICULTURE (18 PERCENT) AND MINING (21 PERCENT) LEADING THE WAY.

3. THE FOREIGN SECTOR REQUIRED PRIORITY ATTENTION BY THE NEW GOVERNMENT, AND GOC MEASURES IN THIS AREA HAVE SHOWN IMPRESSIVE SHORT-RUN SUCCESSES. RESCHEDULING OF MOST OF CHILE'S FOREIGN DEBT THROUGH 1974, IMF DRAWINGS, AND NEW CREDITS FROM US AND OTHERS HAVE GIVEN GOC THE NECESSARY FINANCIAL FLEXIBILITY TO ELIMINATE MOST IMPORT QUOTAS AND TO LOWER TARIFFS. FAVORABLE AVERAGE 1974 COPPER PRICES AND EXPANDED MINERALS OUTPUT WILL RAISE EXPORT EARNINGS TO APPROXIMATELY \$2.1 BILLION THIS YEAR, UP 55 PERCENT FROM 1973. NEVERTHELESS, LARGE CAPITAL GOODS IMPORTS TO REPLACE WORN OUT EQUIPMENT AND THE CONTINUING NEED FOR MASSIVE AGRICULTURAL INPUTS WILL PRODUCE A 1974 CURRENT ACCOUNT DEFICIT IN THE BALANCE OF PAYMENTS OF ABOUT \$475 MILLION -- APPROXIMATELY 23 PERCENT OF TOTAL 1974 EXPORTS.

4. GOC TARGETS FOR 1975 ARE TO REDUCE PUBLIC SECTOR DEFICIT TO 10-12 PERCENT OF EXPENDITURES AND INFLATION TO APPROXIMATELY 150 PERCENT. THEY HO E FOR GROWTH OF NO LESS THAN 5 PERCENT. PERSONAL INCOMES ARE TO BE KEPT AT THE 1974 LEVEL OR A LITTLE HIGHER.

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5. PRESENT INDICATIONS ARE THAT CHILE'S EXPERIMENT WITH ECONOMIC LIBERALISM HAS SUFFICIENTLY STRONG BACKING IN THE MILITARY JUNTA TO WITHSTAND A FEW DISAPPOINTMENTS WITHOUT PROVOKING A SHARP DEPARTURE FROM THE PRESENT COURSE. WHILE NO ALTERNATIVE PROGRAM HAS BEEN PRESENTED, THERE IS CONSTANT PRESSURE TO EASE UP ON THE RIGORS OF AUSTERITY AND TO REVIVE CONSUMPTION THROUGH INCREASED DEFICIT SPENDING.

6. THE MOST SERIOUS THREAT TO THE PRESENT PROGRAM AND CHILE'S ECONOMY IN GENERAL IS OUTSIDE THIS COUNTRY'S CONTROL -- THE HIGHLY VOLATILE INTERNATIONAL ECONOMIC CLIMATE. WITH COPPER COMPRISING AT LEAST 70 PERCENT OF ITS EXPORTS, CHILE IS A CLASSIC CASE OF THE VULNERABILITY OF A SINGLE EXPORT ECONOMY. WHILE COPPER PRICES FELL FROM AN AVERAGE OF \$1.08 A POUND DURING THE FIRST HALF OF 1974 TO SPOT LONDON PRICE OF JUST ABOVE 60 CENTS A POUND IN SEPTEMBER, THE PRICES CHILE PAYS FOR ITS IMPORTS CONTINUED TO CLIMB. EVEN WITH COPPER EXPORT VOLUME UP 10 PERCENT IN 1975, CHILE'S EARNINGS COULD EASILY FALL BY \$200 MILLION; EXPECTED PRICE RISES FOR CHILE'S IMPORTS WOULD FURTHER COMPOUND THE BALANCE OF PAYMENT PROBLEM. ALTHOUGH SOME EXPORT DIVERSIFICATION IS OCCURRING, COPPER

EARNINGS WILL SET THE TONE FOR THIS ECONOMY FOR MANY YEARS TO COME.

7. IF THE BALANCE OF PAYMENTS DOES DETERIORATE IN 1975, CHILE WILL NEED SUBSTANTIAL ADDITIONAL DEBT RELIEF AND NEW FOREIGN CREDITS. THERE IS ROOM FOR SOME REDUCTION IN AGRICULTURAL AND INTERMEDIATE GOODS IMPORTS, BUT SHARP CUTBACKS IN OTHER IMPORTS WOULD CAUSE SEVERE ECONOMIC STRAINS. IF INSUFFICIENT EXTERNAL RESOURCES ARE AVAILABLE, THE GOC MAY FEEL CONSTRAINED TO SLOW DOWN FOREIGN SECTOR LIBERALIZATION AND RESTORE TIGHT QUANTITATIVE IMPORT CONTROLS.

8. GOC POLICY MAKERS ARE POWERLESS TO INFLUENCE THE INTERNATIONAL ECONOMIC ENVIRONMENT AND WE KNOW OF NO PLANS THEY ARE MAKING FOR THE WORST CONTINGENCIES. THEY TALK PUBLICLY OF SOME RELAXATION OF AUSTERITY IN 1975 AS INFLATIONARY PRESSURES DECREASE. MOST GOC LEADERS REALIZE THAT EVEN WITH LIMITED OFFICIAL USE

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LUCK AND GOOD POLICIES, IT WILL TAKE 3-5 YEARS FOR CHILE TO BE DEFINITELY ON THE ROAD TO RECOVERY. MEANWHILE, TIMES WILL BE TOUGH HERE.

9. MORE DETAILED ANALYSIS FOLLOWS BY AIRGRAM.
POPPER

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